

In a typical sale/lease back transaction, Customer A purchases equipment from Retailer B, and then sells it to Lessor C, who then leases the equipment back to Customer A. Customer A has generally paid tax when purchasing the equipment in the first transaction under a taxable retail sale. The second transaction, the sale between Customer A the Lessor C, is generally a nontaxable occasional sale, provided that Customer A is not in the business of selling like-kind property. The third transaction, the lease between Lessor C and Customer A, is nontaxable, provided that it constitutes a "true lease". See, 86 Ill. Adm. Code 130.110. (This is a PLR.)

August 23, 2001

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see <http://www.revenue.state.il.us/legalinformation/regs/part1200>), is in response to your letter of August 1, 2001 and the additional documentation subsequently sent by facsimile to our office. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to AGENCY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither AGENCY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

The AGENCY hereby requests a sales and use tax letter ruling from the Illinois Department of Revenue (the 'Department') pursuant to 20 ILCS 2515/3, and 2 Ill. Adm. Code 1200.110, with respect to a proposed leveraged lease transaction (the 'Transaction') contemplated by the Agency.

I. APPLICANT INFORMATION

1.1 The applicant is the Agency. Its Federal taxpayer identification number is ##, its Illinois tax identification number is ## and its Illinois tax exemption number is ##.

1.2 The Agency's address is ADDRESS.

II. FACTS

2.1 The Agency is a body corporate and politic created by a Compact between the states of STATE1 and STATE2. 45 ILCS 100/1 et seq. as amended; Section 70.370 et seq., RSMo, as amended; as approved by the United States Congress: 64 Stat. 568, August 31, 1950; 73 Stat. 582, September 21, 1959; 99 Stat. 477, September 30, 1985; 110 Stat. 883, April 1, 1996. The Agency provides public transit services in the CITIES/COUNTIES. The Agency is managed and administered by a board of 10

commissioners, five of whom are appointed by the governor of each state. The commissioners serve, without compensation, for five year terms.

2.2 In Rev. Rul. 54-496, 1954-2 C.B. 60, the Internal Revenue Service held that the Agency was a 'political subdivision' within the meaning of Section 22(b)(4) of the Internal Revenue Code of 1939 (the predecessor section to Section 103 of the 1986 Code) and that therefore, interest on bonds issued by the Agency is exempt from federal income tax. As a political subdivision, the Agency is exempt from Federal income tax under Section 115 of the Internal Revenue Code of 1986, as amended.

2.3 The Agency is exempt from Illinois income tax by reason of its Federal exemption pursuant to 35 ILCS 5/205(a), from liability for Illinois sales and use tax on its purchases pursuant to 35 ILCS 105/3-5(4) and 120/2-5(11) and from personal property and real property taxation under 45 ILCS 110/2, which treats the Agency as a city in the State of Illinois for personal and real property tax purposes. All real property owned by cities in Illinois is exempt from property taxation under 35 ILCS 200/15-60.

Moreover, under 35 ILCS 200/15-103(a), real property owned by the Agency is exempt from property tax and under 35 ILCS 200/15-103(b), such exemption is not affected by certain lease financing transactions.

2.4 The Agency is organized into the following operating divisions: DIVISIONS. NAME, the largest operating division of the Agency, operates the area mass transportation systems in STATES, including NAME, which went into service in DATE. Upon its opening in 1993, NAME was a state-of-the-art light rail system with more than 18 miles of track and 20 stations.

With the expansion of the NAME light rail line to PLACE, coming on-line in 2001, 34 additional light rail vehicles were ordered from COMPANY (the 'Vehicles') and a 45,000 square foot light rail vehicle maintenance facility (the 'Maintenance Facility') was constructed at PLACE. A description of the Vehicles and the Maintenance Facility is contained in Exhibit A previously forwarded to your office.

Ten Vehicles were delivered in 2000 and are currently in service. Twenty Vehicles were to be delivered by May, 2001 and the remaining four Vehicles are scheduled to be delivered by December, 2001. The Maintenance Facility was completed in early 2001 and is currently being utilized.

2.5 The business purposes for entering into the Transaction include generating funds to support capital and operating needs and reducing its Vehicle acquisition costs. This type of transaction has been used to finance equipment acquisitions by transit authorities in other large U.S. cities. The use of this type of financing device is sanctioned by the AGENCY.

2.6 The Transaction will be structured as follows:

A. The Agency will lease the Vehicles to a trust (the 'Trust') created and beneficially owned by an institutional investor (the 'Equity Investor') for a term greater than the estimated useful life of the Vehicles. The rent payable to the Agency under this lease (the 'Head Lease') will be prepaid and will be equal to the fair market value of the Vehicles as determined by an independent appraisal.

B. The Trust will simultaneously lease the Vehicles back to the Agency (the 'Sublease'). The Sublease will be a long-term triple net lease at fair lease value and will grant the Agency a fixed price 'purchase option' at the end of the sublease term (the 'End of Term Option'). If the Agency does not exercise the End of Term Option, the Trust will acquire title to the Vehicles and will have the option to retain and operate the Vehicles for its own account or it may require the Agency to enter into or procure service agreements whereby the Agency (or a third party acceptable to the Trust) is required to purchase services (the 'Service Contract') generated by the Vehicles after the Sublease term. The combined term of the Sublease and the Service Contract will not exceed 80% of the useful life of the Vehicles.

C. The Agency will economically defease its lease and End of Term Option obligations under the Sublease through a guaranteed payment undertaking and such agreement will be pledged to the Trust.

D. With respect to the Vehicles acquired in 2000 and delivered in 2001, the Transaction is expected to close by DATE. With respect to the Vehicles to be delivered in 2001, the Transaction is expected to close by DATE.

E. At all times during the term of the Head Lease and Sublease, the Agency will have possession and operational control over the Vehicles, will retain title to the Vehicles and its obligations under the Sublease will be defeased.

F. Copies of drafts of the Head Lease, the Sublease and all other documents evidencing the Transaction are attached as Exhibit B as required by 2 Ill. Adm. Code 1200.110.b.2.

III. RULING REQUESTED

The Transaction will not be subject to Retailer's Occupation Tax or Use Tax under 35 ILCS 105 or 120, the Metro East Mass Transit Sales and Use Tax under 70 ILCS 3610/2, the Home Rule Municipal Retailer's Occupation Tax under 65 ILCS 5/8-11-1, the Service Use Tax under 35 ILCS 110 or the Service Occupation Tax under 35 ILCS 115.

IV. LEGAL ANALYSIS AND DESIRED RESULT

4.1 The Retailer's Occupation Tax ('sales tax') is imposed on sales of tangible personal property at retail. 35 ILCS 120/2. A sale 'at retail' means any transfer of the ownership of or title to tangible personal property to a purchaser for the purpose of use or consumption. 35 ILCS 120/1. Sales of tangible personal property to governmental agencies and not for profit corporations that possess an active exemption identification number (a so-called 'E' number) are exempt from sales tax. 35 ILCS 120/2-5(11), 86 Ill. Adm. Code 130.120(i). Receipts from the lease or rental of tangible personal property are not subject to sales tax although the lessor is generally treated (absent another applicable exclusion) as the end user of such tangible personal property and is subject to sales tax on its purchase of the tangible personal property. 86 Ill. Adm. Code 130.2010(b). Finally, tangible personal property sold to a lessor who leases the property, under a lease of one year or longer to a governmental body that has an active exemption number, is exempt from sales tax. 35 ILCS 120/2-5(37).

The Use Tax is imposed upon the privilege of using in the State of Illinois, tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. A purchase at retail means the acquisition of the ownership of or title to tangible personal property through a sale at retail. 35 ILCS 105/2. There are exemptions from use tax that are complimentary to those found in the sales tax provisions for sales of tangible personal property to governmental agencies and for property sold to a lessor who leases the property under a lease of one year or more to a governmental agency which has an active exemption number issued by the Illinois Department of Revenue. 35 ILCS 105/3-5(4), (32).

The Service Occupation Tax ('service sales tax') is imposed on all tangible personal property transferred incident to a sale of service by persons (referred to as 'servicemen') engaged in the business of making sales of service. 35 ILCS 115/3. Tangible personal property is treated as being transferred if title or ownership of the property is transferred. 35 ILCS 115/2. A sale of service does not include any sale or transfer of tangible personal property incident to the rendering of service for or by any governmental body if the entity has an active exemption identification number issued by the Illinois Department of Revenue. 35 ILCS 115/2, 86 Ill. Adm. Code 140.125 (h)(3), 140.201. Tangible personal property sold to a lessor incident to a sale of service who leases the property for a period of one year or longer to a governmental agency which has an active exemption number issued by the Illinois Department of Revenue, is also exempt. 35 ILCS 115/3-5(25).

The Service Use Tax Act imposes a use tax on the use in Illinois of real or tangible personal property purchased incident to the purchase of a service from a 'servicemen'. 35 ILCS 110/3. Tangible personal property is deemed to be purchased if the purchaser has acquired ownership of or title to the property. 35 ILCS 110/2. However, if the sale of tangible personal property is not subject to the service sales tax as a servicemen, then the service use tax does not apply to the use of such property. 86 Ill. Adm. Code 160.101(a). An exemption from the definition of sale of service exists that is similar to the one found in the service sales tax provisions for tangible personal property transferred incident to the rendering of service to or by a governmental entity. 35 ILCS 110/2. There is also an exemption for tangible personal property purchased by a lessor incident to a sale of service who then leases the property for a period of one year or longer to a governmental agency which has an active tax exemption number issued by the Illinois Department of Revenue. 35 ILCS 110/3-5(24).

The Metro East Mass Transit Sales and Use Tax and the Home Rule Municipal Retailer's Occupation Tax both utilize the same tax base as the Retailer's Occupation Tax and thus, the same exemptions apply. 70 ILCS 3610/5.01 (b) and 65 ILCS 5/8-11-1, respectively.

4.2 With respect to this Transaction, the law is applicable as follows:

A. If the Head Lease of the Vehicles is characterized as a 'sale' of tangible personal property, no sales or use tax would be incurred pursuant to the complimentary exemptions at 35 ILCS 120/2-5(37) and 35 ILCS 105/3-5(32), respectively. These exemptions provide that the sale of tangible personal property (in this case, the Vehicles) to a lessor (in this case the Trust) who then leases the property under a lease of one year or more (in this case, the Sublease) to a governmental body that has an active tax exemption number (in this case, the Agency), is exempt. This exemption also exists with respect to the service sales tax and service use tax as well at 35 ILCS 115/3-

5(25) and 35 ILCS 110/3-5(24), respectively, thereby eliminating any potential application of those taxes as well.

B. The Metro East Mass Transit Sales and Use Tax and the Home Rule Municipal Retailer's Occupation Tax utilize the same tax base as the Retailer's Occupation and Use Tax. Consequently, the principles outlined herein will apply to these taxes with the result being that with respect to the Vehicles, those taxes will not be incurred.

V. CONCLUSIONS AND PROCEDURAL STATEMENTS

5.1 For the reasons set forth herein, the consummation of the Transaction with respect to the Vehicles will not result in the imposition of Retailer's Occupation, Use, Service Occupation or Service Use Tax under 35 ILCS 120, 105, 115, or 110 respectively, the Metro East Mass Transit Sales and Use Tax, 70 ILCS 3610/2, or the Home Rule Municipal Retailer's Occupation Tax, 65 ILCS 5/8-11-1.

5.2 We have enclosed a proposed draft letter ruling for the Department's consideration. See Exhibit C attached to this request. Please address your ruling letter to AGENCY.

5.3 To the best of the knowledge of the Agency and the undersigned: (a) the issues herein presented, with respect to the Agency, are not presently under investigation or audit by the Department; (b) neither the Agency nor any other person, partnership, corporation, or entity is presently pursuing any protest, litigation, or negotiation, or is otherwise involved with the Department on the issues presented herein; (c) the Agency previously submitted on June 6, 1997, a request for a letter ruling in response to which the Department issued a General Information Letter dated August 7, 1997. After providing additional documents with respect to the original ruling request, the Agency withdrew its request; and (d) the Agency and the undersigned have not located any authorities contrary to the positions asserted herein.

5.4 If any decision is under consideration by the Department that is inconsistent or contrary to the foregoing letter ruling request, the Agency respectfully requests a conference before any such decision is actually made.

5.5 An executed Power of Attorney authorizing the undersigned to represent the Agency in connection with this letter ruling request was previously forwarded to you.

Please do not hesitate to contact me if you have any questions or desire any additional information. We greatly appreciate your prompt assistance in this matter.

The transaction which you have detailed in your letter and the accompanying schedule of leases constitutes a typical sale/leaseback transaction. These transactions are more fully described in the Department's regulations found at 86 Ill. Adm. Code 130.110. Typically, Customer A purchases equipment from Retailer B, and then sells it to Lessor C, who then leases the equipment back to Customer A. Customer A has generally paid tax when purchasing the equipment in the first transaction under a taxable retail sale. The second transaction, the sale between Customer A the Lessor C, is generally a nontaxable occasional sale, provided that Customer A is not in the business of selling like-kind property. The third transaction, the lease between Lessor C and Customer A, is nontaxable, provided that it constitutes a "true lease," which is more fully described in Section 130.2010 of the Department's regulations (see enclosed copy).

The materials submitted with your ruling request document a series of transactions in which AGECONY purchases light rail vehicles (hereinafter, "vehicles") from COMPANY and then sells those vehicles under a conditional sales agreement ("Head Lease") to the Trust. The Trust then leases those vehicles back to AGENCY under a true lease agreement. The information you have provided indicates that the sale/leaseback contracts will be executed on August 24, 2001.

Your letter and follow-up materials indicate that at the time of this ruling, 29 of the 34 vehicles have been delivered to the Agency at various times from February, 1999 through the second quarter of 2001.¹ The Agency has purchased these vehicles tax-free by proffering its exemption identification number ("E" number) to the seller, COMPANY. Five vehicles remain to be delivered after the date of the execution of the sale/leaseback transactions. You indicated in a recent telephone conversation that the sale/leaseback documents contemplate incorporation of these later-delivered vehicles through their inclusion on a schedule to be appended to the sale/leaseback documentation.

It is our opinion that the sale of the vehicles by the Agency to the Trust is exempt from Retailers' Occupation Tax liability. There are several bases, we believe, for this determination. We base our opinion primarily on our determination that these sales are made by an exempt governmental agency in the performance of a governmental function. This analysis, we believe, applies to all 35 vehicles sold by the Agency to the Trust. Sales by exempt governmental units are oftentimes taxable. Such is the case, for instance, for sales of food at public stands by park districts. However, sales of motor vehicle license plates by the State of Illinois is considered exempt since such sales are made in performance of a specific governmental function. See the enclosed copy of 86 Ill. Adm. Code 130.2055. Article II of the COMPANY,² authorizes the creation and development of the AGENCY. The Agency is specifically vested with the power to plan, construct, maintain, own and operate various types of transportation facilities. See, Article III, Par. (2) of the Compact. Article III, Par. 7 of the Compact provides that the Agency also has the power to "perform all other necessary and incidental functions ..." in respect to this purpose. Further evidence of the Agency's broad powers can be found in Article VI of the Compact, which provides that the Agency "is vested with all necessary and appropriate powers not inconsistent with the constitution or the laws of the United States or of either state ..." to effectuate the development of the District. The Agency has purchased the vehicles in furtherance of its purpose of providing public transit services through the NAME system, and has made the sale to the Trust to effectuate this purpose (e.g., the sale is the mechanism by which the Agency is able to obtain financing and effectuate expansion of the NAME system).

Characterization of the Head Lease as a sale made in performance of a governmental function is also indirectly supported by provisions in the Property Tax Code which specifically acknowledge the sale/leaseback transactions entered into by the Agency, and clarify that these transactions do not destroy the Agency's exempt property tax status. Section 200/15-103 (b) of the Property Tax Code³ states that the Agency's property tax exemption is not

"affected by any transaction in which, for the purpose of obtaining financing, the Agency, directly or indirectly, leases or otherwise transfers the property to another for which or whom property is not exempt and immediately after the lease or transfer enters into a leaseback or other agreement that directly or indirectly gives the Agency a right to use, control, and possess the property. In the case of a conveyance of the property, the Agency must retain an option to purchase the property at a future date, or within the limitations period for reverts, the property must revert back to the Agency."

The transactions described in Section 15-103 (b) of the Property Tax Code are similar, if not identical, to those which form the subject of the Agency's ruling request. The provisions of Section

15-103 strongly suggest that the legislature considers performance of the sale/leaseback transactions to be a typical and necessary aspect of the Agency's governmental functions.

As indicated above, other bases can be asserted to support the exempt nature of the sale by the Agency to the Trust. The information you have provided indicates that approximately 29 of the 35 vehicles have been used by the Agency prior to execution of the sale/leaseback transaction (they were delivered, as noted above, from February, 1999 through June, 2001). The sale of these vehicles to the Trust could thus also be characterized as an occasional sale pursuant to the provisions of Section 130.110 of the Department's regulations (see enclosed copy). We must note that when an exempt organization purchases items with the intent to resell them, the occasional sales exemption cannot be claimed. Your letter indicates, however, that these vehicles were not purchased with the intent to resell them.⁴ No Retailers' Occupation Tax would be incurred by the Agency, given an occasional sale to the Trust. Concomitantly, the Trust would not incur any Use Tax liability. The sublease between the Trust and the Agency is not taxable, since it constitutes a "true lease." The Agency is not obligated to purchase the vehicles at the end of the lease period, but can do so (the selling price is not nominal). True lease transactions are more fully described at 86 Ill. Adm. Code 130.2010, enclosed. If the Agency decides to exercise the purchase option at the end of the lease term, this sale would not be taxable, provided the Agency proffers its active "E" number to the Trust. Purchase of the vehicles would be a purchase made in furtherance of the Agency's organizational purposes.

Since it appears that the other five vehicles will be purchased and sold simultaneously, their sale cannot be characterized as an occasional sale. However, for these vehicles⁵, an exemption is provided by the terms of Public Act 92-227. This recently-passed legislation⁶ provides an exemption from Retailers' Occupation Tax and Use Tax for sales to lessors who lease the property, under a lease of one year or longer executed or in effect at the time the lessor would otherwise be subject to tax, to a governmental body that has been issued an active "E" number by the Department. The lease from the Trust to the Agency is a lease for one year or longer, and is in effect at the time the lessor would be subject to tax on the five vehicles (delivery date). AGENCY possesses an "E" number issued by the Department. Thus, all the requirements of Public Act 92-227 are met. If the Agency purchases the vehicles at the end of the lease period, no tax would be due if the Agency proffers its active "E" number to the Trust.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Jerilynn T. Gorden
Senior Counsel - Sales and Excise Tax

JTG:msk
Enc.

¹ Vehicle numbers 3020 through 3024 are anticipated to be delivered to AGENCY between October 1, 2001 and January 1, 2002. Your letter indicates that there will be a subsequent "closing" of a portion of the sale/leaseback transactions in December, 2001, for four of these vehicles.

² See, 45 ILCS 100/1 et seq.,

³ See, 35 ILCS 200/15-103

⁴ Additional materials which you submitted indicate that contracts for the manufacture of the vehicles were executed between August 2, 1996 and August 30, 1999. Utilization of the sale/leaseback transactions was not approved by the Board of Commissioners until June 22, 2001. Although the sale/leaseback transactions were contemplated prior to June 22, 2001, your letter indicates that "the decision to acquire the Vehicles was for the sole purpose of furthering the Agency's exempt purpose to provide public transit services through the NAME expansion and predates the decision to enter into the Transaction [sale/leaseback] by a considerable amount of time."

⁵ As indicated more fully in footnote five (5), Public Act 92-227 restores an exemption that was available from January 1, 1996 through December 31, 2000. This exemption was not available for the period of January 1, 2001 through August 1, 2001. We do not believe that it would apply to any of the earlier-delivered vehicles because in order to claim the exemption, the sublease between the Trust and AGENCY must have been in effect at the time the Trust would otherwise have incurred tax on its purchase of the vehicles. The information provided indicates that the sublease between the Trust and AGENCY was not in effect at this time.

⁶ Public Act 92-0227 (Senate Bill 617) restores an exemption that was sunsetted for sales on and after January 1, 2001. The legislation restored this exemption, effective for sales on and after August 2, 2001.